



The negative effects of monetary expansion on long-run economic growth: evidence from Southern and Northern-central European countries

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Abstract

This thesis investigates the effects of monetary expansionary policy on the economy following the Austrian Theory of Business Cycles. In accordance with this school of thought, the interventions of monetary authorities are believed to have adverse effects on the sustainable path of economic growth. Attempting to mitigate business cycles, liquidity injections intensify fluctuation in the long run. The origin of the Neo-Austrians' approach and its differences with mainstream economic arguments, are described in the first part of the thesis. In the second part, I will study the cases of three Northern-central European countries and, for the first time, three Southern European countries: Germany, Netherlands and Belgium, as well as Italy, Spain and Portugal. The results obtained are consistent with the idea that the injection of ex-nihilo credit in the system creates internal disequilibria in the economy. The unbalances eventually lead to unproductive investment of the available resources and slow down the economic growth. In the short term monetary expansions brings about an economic boom since both the output and investment increase due to the higher level of capital in circulation. But the economy is operating on a fragile base since the resources invested are not backed up by real saving but created out of thin air. In the long run the inconsistency between produced consumable output and consumption preferences leads to an economic recession. Austrian economists advocate for a laissez-faire economy, free from any regulatory intervention. They believe that greater interferences in the markets, lead to more severe recessionary effects.

Introduction

The recent economic crisis rekindled interest in the Austrian Theory of Business Cycle, both for such characteristics displayed by the crisis and the warning of several economists belonging to this School of thought, who predicted the onset coming of this severe recession for many years.

Some questions arose while reading the explanation that Austrians give for the existence of economic fluctuations:

- How does the volatility of economic cycles influence economic growth?
- Is the growth of the economic system of production weakened by the business cycles?
- Do monetary policies detrimentally impact the economy by causing those economic fluctuations?

Those are some of the enquiries deeply analyzed in this study, which presents the explanatory power of the Austrian business cycle theory. This analysis exhibits not only empirical and historical evidences, but also a detailed explanation of the mechanism that brings them about.